

COMMONWEALTH OF MASSACHUSETTS  
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Investigation by the Department of )  
Telecommunications and Energy on its own ) D.T.E. 02-40  
Motion into the Provision of Default Service )

---

REPLY COMMENTS OF TXU ENERGY RETAIL COMPANY LP

---

John A. DeTore  
Christopher H. Kallaher  
Rubin and Rudman LLP  
50 Rowes Wharf  
Boston, MA 02110  
(617) 330-7213

Tom Rose  
Vice President  
TXU Energy Retail Company LP  
1601 Bryan Street  
Dallas, TX 75201  
(214) 812-3247

## **INTRODUCTION AND EXECUTIVE SUMMARY**

The Department has received comments from over thirty parties with varying interests. Notwithstanding the diversity of the participants, there appears to be near consensus on three critical points. The first is that the Department's treatment of default service is crucial to the future of electric restructuring in the Commonwealth. As matters now stand, the great majority of Massachusetts customers will become default service customers in March of 2005. Whatever policies the Department puts in place for default service will shape the framework of the competitive market in Massachusetts for the foreseeable future.

The second point of consensus is that retail choice is simply not a reality for the great majority of Massachusetts customers. No party disputes the DOER data which demonstrates that only about 1% of small business and residential customers takes service from a competitive supplier. The third point on which there is near, but not total, consensus is that true retail choice for the many small business and residential customers is a worthy policy goal.

Not unexpectedly, the greatest divergence of opinion comes on the issue of how best to achieve this goal. As we stated in our initial comments, the Department is faced with a stark choice. The distribution companies would like to lock in their current position as monopoly providers of retail service to consumers, and their proposals reflect this desire. They differ superficially, and only to the degree that each pays lip service to the concept of encouraging retail competition. NSTAR is least ambitious in this regard, taking the view that the restructuring process is complete and that all the goals of the legislation have been accomplished. NSTAR argues the current system of providing default service passes through to customers the benefits of the wholesale market and that we should aspire to nothing

more for most customers. National Grid offers what appears to be a major overhaul of default service, but its plan does little more than change the name of the current process from wholesale to retail. The distribution companies continue to perform all retail services and competitive suppliers do no more than provide the wholesale power in much the same way which they do now. In effect, nothing significant changes from the status quo other than requiring the current wholesale suppliers of default service to become licensed as retail suppliers. Indeed, the revised Grid proposal gives up even that very modest change by allowing wholesale suppliers to continue to participate in the default service auctions. The Grid proposal does nothing to encourage retail competition, and will result in higher default service prices for consumers.

On the other hand, TXU has put forth a plan which will create true retail competition for small business and residential customers. As we discuss in more detail below, the critical element of that plan is the unbundling of retail services from the wires cost. While TXU acknowledges that there are still practical implementation problems to be explored before its vision of a true competitive market can be achieved, the critical path activity is retail unbundling. We suggest several measures that can streamline this process while bringing immediate improvements to the manner in which default service is priced and procured. While the Department conducts a retail unbundling proceeding, it should adopt some form of DOER's proposal for improving wholesale procurement for default service on an interim basis. Unless the Department begins this process now, however, there will be no true retail alternative available by March of 2005.

The Department has the difficult task of determining the future of restructuring. We are confident that the Department will do what it deems to be in the best interest of all customers. TXU

asks only that the Department set forth a clear policy, and the concrete steps it will take to achieve that policy, so that TXU, and other suppliers, can plan accordingly.

## **ARGUMENT**

### **DESPITE THEIR NUMBER, THE COMMENTS OFFER ONLY TWO VISIONS FOR THE FUTURE OF THE MASSACHUSETTS RETAIL MARKET.**

Many parties filed comments in this important docket, which is encouraging. The Department should be pleased that so many parties, representing many interests, have offered their views on the future of default service and the retail electricity market in Massachusetts. From these many comments, however, only two distinct alternatives emerge. One is represented by the comments filed by the distribution companies, primarily NSTAR and National Grid. These parties take the position, in slightly different forms, that the restructuring process is over, and residential and small commercial customers have gotten all they can ever hope to get from it, namely an efficient pass-through of wholesale prices. The other is represented by comments filed by TXU and other retail suppliers, including Centrica and the Competitive Retail Suppliers. TXU believes, as we hope the Department believes, that there is still great promise for the retail market in Massachusetts, if the Department takes the steps necessary to create such a market.

#### **A. The NSTAR and National Grid proposals retain the current structure of default service procurement as a wholesale arrangement.**

While the NSTAR and National Grid proposals appear to be different, they share a central governing principal: utilities should continue to be the sole providers of retail services to residential and small commercial customers. NSTAR states this principle most clearly. Its position is that the current default service system provides consumers the benefit of a pass-through of prices from a wholesale

market that is working well, and that this is the most consumers can expect. The Department can, thus, declare victory and move on to other things. NSTAR is untroubled by the fact that this view would result in it remaining the monopoly provider of retail services to its Massachusetts consumer customers, perhaps in perpetuity.

The National Grid proposal spends many pages describing detailed schemes for auctions involving default service customers and suppliers. When reduced to its essence, however, this proposal is nearly identical to the vision laid out in NSTAR's comments. Both retain the utility as the sole provider of all retail services associated with default service. Both keep the costs for those services embedded in the utilities' distribution rates, where retailers cannot compete against them. And both would do nothing to stimulate the development of a retail market.

In its comments, Grid shows its true colors by abandoning even the pretense that retail suppliers should take over the default service obligation in any sense. Grid now proposes that it will accept bids in its "retail auction" from wholesale suppliers as well as retail suppliers. "Specifically, we are proposing to accept wholesale bids for basic service to supply default service customers that will be the same in all respects to retail basic service, but will not involve a retail switch of the customer account." National Grid Initial Comments at 11. This is a telling description of the Grid's previous "retail" proposal. The fact that the "retail" auction can accommodate wholesale suppliers without being changed in any respect other than the nominal identity of the retail supplier proves that "retail basic service" is, in truth, a wholesale service. In either case, the only "service" provided by the non-utility supplier is wholesale generation; the utility continues to provide all services that involve a direct relationship with the customer. This is the same retail arrangement that existed before the Restructuring Act took effect; the Grid's plan would lead Massachusetts backward, rather than forward.

None of the utility proposals would allow, much less encourage, the development of a retail market in Massachusetts. In fact, they would ensure that no retail market would develop here for the foreseeable future. Competitive retailers like TXU, Centrica, and Green Mountain who are following, but have not yet entered, the Massachusetts market need to see real changes in the market structure that would create a true retail service against which they can compete. As discussed in TXU's initial comments, in the current system, retailers compete against a wholesale generation price, while the price for other retail services remains embedded in the utility's distribution charges. The utility proposals do nothing to change this critical flaw in preparation for the expiration of standard offer service in early 2005. At best, they add cosmetic changes meant to give the appearance of retail competition while cementing the utility's status as de facto monopoly provider of service to residential and small commercial customers. Worse still, as described below Section D, these cosmetic changes will increase the costs of service to all customers, even as the utility retains its nearly 100 percent market share among the consumer rate classes.

**B. The Unbundling Recommended in TXU's Initial Comments Is The Essential Element Needed to Create A Competitive Retail Market.**

None of the utility proposals address the fundamental problem of market structure. They all retain the basic market structure in which "generation service" remains essentially a wholesale service, while the utility continues to provide all of the retail services that create customer relationships with consumers. The only way to create a market in which TXU and the other retailers will compete is to first create a true retail service. To do this, the Department must unbundle the costs of retail services from the utilities distribution rates, and open those retail services to competition to the maximum extent allowable. Where provisions of the Act constrain the Department from opening a service to

competition, (as is the case with billing), the Department should at least allow retailers to procure those services from the utility on behalf of their retail customers, paying the utility a non-discriminatory Department-approved rate that would result from an unbundling proceeding.

An unbundling proceeding is absolutely critical to achieve the necessary re-orientation of the retail market. The pseudo-retail measures suggested in this proceeding will not work, and will only raise prices. The same is true for artificially raising generation prices, either by cross-subsidizing delivery services as the Grid suggests, or by imposing a “retail adder,” as some have suggested in other states. But by combining an unbundling proceeding with immediate improvements in the current default service, the Department can once again put Massachusetts at the forefront of electric restructuring.

**1. Through an appropriate unbundling proceeding, the Department can create a appropriate structure for the post-standard offer market.**

There is a growing realization among states and countries that have moved forward with electric restructuring that full rate unbundling is the *sine qua non* of a competitive retail market. The United Kingdom led the way in this respect, when it structurally separated the distribution functions of its formerly state-owned utility from the retail functions. *See, e.g., Review of Domestic Gas and Electricity Competition and Supply Price Regulation*, Office of Gas and Electricity Markets (“Ofgem”) (November 2001); *Separation of PES Businesses: Review of C12 Licence Obligations*, Ofgem Consultation Paper (February 2001). Texas used a similar approach when it structurally separated the distribution and retail functions of its major utilities. TXU saw first-hand that such a separation, which can only be accomplished with full rate unbundling, both stimulates retail competition and improves the service provided by the wires company.

Full structural separation is not necessary, however, to create a market structure that allows retail competition to take hold. Full rate unbundling, combined with appropriate standards of conduct, which Massachusetts already has in place, can sufficiently separate the distribution function from the retail business. New York and New Jersey have embarked on this path to creating competitive retail markets. The New York commission, for example, “concluded that a prerequisite to fostering retail market development is the establishment of unbundled rates for competitive or potentially competitive functions that reflect fully allocated costs.”<sup>1</sup> Both states are conducting full rate unbundling proceedings for their major utilities, with the goal of separating the rates for retail services, which can be provided by the competitive market, from the rates for the wires services, which should remain with the utility. As other states in the Northeast and elsewhere move toward a market structure that will support true retail competition, those states become more attractive to potential new entrants such as TXU, Centrica, and Green Mountain, which must deploy limited resources where they can give the greatest return.

That is not to say that Massachusetts should follow any other state in lockstep, which it has never done. TXU has maintained from the beginning of its involvement in the ongoing restructuring efforts in Massachusetts that each state should find the solution that meets its unique history and needs. In choosing an appropriate approach to unbundling, the Department can find such a solution that makes use of and improves upon the experience of other states.

Texas and New York undertook what amounts to a two-part approach to unbundling, in which issues of statewide application are decided in a generic proceeding, the results of which are then applied

---

<sup>1</sup> *Proceeding on Motion of the Commission Regarding Provider of Last Resort Responsibilities, the Role of Utilities in Competitive Energy Markets, and Fostering the Development of Retail Competitive Opportunities – Unbundling Track*, Case 00-M-0504, Order Directing Filing of Embedded Cost Studies (November 9, 2001), citing Order Directing Expedited Consideration of Rate Unbundling (March 29, 2001).



to each utility in individual rate proceedings.<sup>2</sup> While ultimately effective, such an approach may not be best for Massachusetts. We respectfully suggest that the Department consider a more streamlined approach: direct the distribution companies to file embedded cost-based tariffs for each service that is part of the bundled retail service it provides to default service customers. These would include:

- ?? Generation (including all procurement and administrative costs);
- ?? Wires-only distribution service;
- ?? Metering (including meter reading);
- ?? Transmission;<sup>3</sup>
- ?? Billing services;
- ?? Credit and collections services; and
- ?? Customer service (including customer information systems).<sup>4</sup>

Each utility would be required to support its tariff filing with cost studies as it deemed appropriate in order to comply with G.L. c. 164, §94. This approach would offer several administrative and substantive benefits:

- ?? The six-month suspension period would ensure that the proceedings do not extend indefinitely, delaying the implementation of an appropriate market structure for default service;<sup>5</sup>
- ?? Issues of statewide importance would be addressed in the first tariff case to come before the Department, which would set the precedent for and, thus, streamline the remaining tariff cases;<sup>6</sup>

---

<sup>2</sup> See *supra*, Note 1.

<sup>3</sup> Massachusetts utilities already have transmission tariffs in place as a result of the Department's implementation of the 1997 Restructuring Act.

<sup>4</sup> The tariffs for individual services would be used primarily by retailers for purposes of procuring utility services or identifying the utility cost against which the retailer would be competing. The price for each item would not need to appear on each consumer's bill, and the Department could take steps to ensure that consumer bills would not become any more complicated than under the existing system.

<sup>5</sup> The Department could stagger the timing of the utility tariff filings to avoid simultaneous review of filings by all four utilities.

<sup>6</sup> The Department employed a similar approach in implementing the Restructuring Act. The Department's findings regarding the extent to which settlements by Massachusetts Electric and Boston Edison "substantially complied" or were "consistent" with the Act were applied to later filings. This allowed the Department to conduct

- ?? The resolution of statewide issues in the first tariff case would increase the opportunity for settlements in the remaining cases, as parties would recognize that they could not re-litigate issues already decided in the first case;
- ?? The Department-approved tariffs resulting from such proceedings would provide a mechanism to immediately implement a retail market structure for default service in a utility's service territory once that utility's tariffs were approved. Potential competitors or alternate default service providers could offer retail services they would supply themselves, in which case the utility's tariffed rate for that service would serve as a "back-out credit," or the retailer could choose to use the existing utility service, in which case it would pass on the tariffed rate to its customers;<sup>7</sup> and
- ?? The resulting structure, in which the rates for all contestable or potentially contestable retail services are unbundled and made transparent to customers, would not only allow competition from non-utility retailers, but would also enable utilities to create retail affiliates that would compete in other services territories, or even other states, thus ensuring continued efficient deployment of their own retail resources.

Even allowing for a staggered schedule of tariff proceedings, this approach would allow the Department to conduct unbundling proceedings and implement an appropriate market structure for default service before standard offer service expires in early 2005.

**2. The Department can implement immediate improvements to default service pricing and procurement, such as those suggested by DOER, that need not wait for the completion of the unbundling proceedings.**

---

those later proceedings with dispatch. For example, the COM/Energy restructuring plan was fully litigated, from filing to final order, in less than four months. *COM./Energy Restructuring*, D.P.U./D.T.E. 97-111 (February 27, 1998).

<sup>7</sup> In the case of retail services that cannot yet be opened to competition, such as billing, all retailers would be required to use the utility's service.

While full retail unbundling remains the critical step to creating a competitive retail market, the Department can take immediate steps to improve default service in the areas of pricing and procurement.<sup>8</sup> In the area of pricing, as other parties suggested, the Department should require utilities to immediately move certain easily identifiable costs from distribution rates to the default service price. These include administrative costs for procuring default service, bad debt attributable to default service customers, and the charges to reconcile default service prices with revenues.

In the area of procurement, several parties, most notably DOER, identified ways in which the current practice can lead to large swings in the default service price, which can lead to hardship for consumers while also making it even more difficult for retailers to compete. As an interim measure, while the unbundling proceedings are underway, the Department should implement some form of the DOER's proposal for improving the procurement process for default service on a statewide basis.<sup>9</sup> In no event, however, should such interim measures extend the "wholesale only" approach to default service beyond the expiration of standard offer, allowing standard offer customers to revert to a utility-provided, wholesale pass-through default service.

**C. National Grid's Criticisms of the TXU Plan Are Misplaced.**

TXU respectfully submits that its proposal for full retail cost unbundling is the key step to creating a robust retail market, and is fully consistent with the policies that have guided the Department through the restructuring process. In its comments, however, National Grid criticized the TXU proposal on a number of grounds. National Grid Initial Comments at 22, n. 3. Some of these are simply

---

<sup>8</sup> In our initial comments, TXU recommended that the Department make no changes to default service in any interim period between now and the implementation of an improved market structure. By this we mean that the Department should reject structural changes to default service, such as those suggested by National Grid, that would not lead to true retail competition.

misunderstandings, caused perhaps by the summary nature of the various presentations at the public hearing and technical conference of the plan. All of these criticisms are misplaced, however, and can be quickly addressed.

**1. The TXU plan would not leave anyone “in the lurch” should a supplier fail.**

TXU recommends a market structure in which all retail services are unbundled from distribution service and offered to customers by competitive suppliers (including, if the utility desired, utility competitive affiliates). Such a system would require a “supplier of last resort” that would provide retail service to customers who are without a competitive supplier for any reason. Should a supplier fail, and no other suppliers step in to offer to serve those customers, the failed supplier’s customers would be switched to the supplier of last resort. No one would be left “in the lurch.”<sup>10</sup>

**2. TXU’s proposal would apply consumer protections to all customers.**

Under the TXU plan, every customer would enjoy the same consumer protections that are available now. For example, the low income rate, which is applied to the utility’s delivery charges, would be available to every qualifying customer, regardless of whether that customer took service from a competitive retailer or a default service provider.

**3. The TXU proposal creates no unwarranted barrier to entry.**

Under the TXU plan, no retailer would be forced to provide any retail service it did not wish to provide. Retailers could simply combine their own generation with retail services such as billing and

---

<sup>9</sup> Proposals such as the Grid auction plan that would only be implemented on a trial or pilot basis in one utility’s service territory will do nothing to improve the overall climate for retail competition in Massachusetts.

<sup>10</sup> This criticism may be more related to National Grid’s concern that it might not be paid any outstanding distribution charges owed by the failing competitive supplier since, under TXU’s plan, the retailer procures distribution service from the utility on behalf of its customers. In such a system, however, as part of a certification process, retailers should have to provide adequate security to ensure that the distribution company would be made whole in the event of a supplier failure.

customer service procured from the local utility at tariffed rates. This system would allow a retailer to operate much as it would under the Grid's retail auction plan, but with the critical difference of branding.

More importantly, the Department should be wary of any proposal that advertises "no barriers to entry" as one of its selling points. If competitors need do nothing to enter a market, it is unlikely that they will offer any benefits to customers if they do enter. Allowing retailers to provide as many retail services as the law allows would impose a barrier to entry by firms wishing to provide such services, but the barrier is an appropriate one. A retailer could not enter the market unless it could provide service more efficiently than the incumbent utility. National Grid's argument ignores the fact that only those retailers who can overcome this barrier have anything of value to offer retail customers. A retailer that only re-sells the utility's service coupled with its own generation offers nothing that is not already available under the current default service structure.<sup>11</sup>

#### **4. The TXU plan would not lead to duplicate systems and costs.**

Here, the Grid confuses competition from an efficient retailer with duplication of systems and costs. Under the TXU plan, retail services would eventually be unbundled and opened to competition. The Department would conduct an unbundling proceeding to identify each utility's costs to provide true distribution service. All other costs, such as those for billing, customer service, and collections, would be moved to a retail cost category, along with cost for generation, to create a true retail default service against which retailers would compete. Retailers would win customers away by offering better prices, better service, and innovative products and services. The facilities retailers would use to provide those

---

<sup>11</sup> National Grid's argument calls to mind the Department's preference for facilities-based competition over resale in the local exchange telephone market. Facilities-based competition certainly has higher barriers to entry than resale, but the Department has recognized facilities-based competition can bring far more value to customers in the long run than mere resale. *See, e.g., ACC National Telecom Corp.*, D.T.E. 97-85 (September 19, 1997) (promoting

services would not “duplicate” the utility’s facilities any more than Ford’s manufacturing plants “duplicate” those of Chevrolet or Toyota. To the extent the retailer is successful, its services displace those of less efficient competitors.

**5. The TXU Plan would not disrupt customer switching or billing.**

As stated in its initial comments, TXU understands that what works well in one state may not be appropriate for another state. One advantage Massachusetts has in this proceeding is that it can take the best practices from other states, apply those that fit here, and reject the ones that do not.<sup>12</sup> There appears to be no reason to change the way customers are switched in Massachusetts, and TXU has not proposed any change.

With respect to billing, contrary to what the Grid claims, the experience in other jurisdictions has shown that retailers can provide billing as efficiently as distribution companies. This has certainly been the case in Texas, and while no system is perfect, the “problems” National Grid cites have occurred at a very low rate, considering the overall size of the market, and have improved greatly since the market was fully opened to competition.<sup>13</sup> Ensuring accurate and timely billing would, of course, be a major concern for the Department, and TXU would support a rigorous program of licensing and testing before a retailer would be allowed to offer such services competitively.

---

facilities-based competition in Massachusetts “over time should lead to lower prices, more innovation, and an enhanced level of service for consumers in the Commonwealth”).

<sup>12</sup> It is clear, for example, that the Texas system for switching customers would not be appropriate for Massachusetts. Texas already had in place a centralized entity, the Electricity Reliability Council of Texas (“ERCOT”), that was well-positioned to act as the clearinghouse for switching transactions for the major Texas utilities. Massachusetts has no entity equivalent to ERCOT that could be used for those purposes any more efficiently than they are already handled by individual utilities.

<sup>13</sup> A recent report to the Public Utility Commission of Texas shows during a recent three month period a 50% reduction in the number of active customers missing one or more bills since January 1, 2002. *See Project No. 24462 - Performance Measures Relating to the Competitive Retail Electric Market*, August 22, 2002 report to Public Utility Commission of Texas. TXU would be pleased to brief the Department in more detail regarding the manner in which billing services are provided in the Texas market.

**6. The TXU plan complies fully with G.L. c. 164, § 1D and Section 312 of the Restructuring Act.**

National Grid argues that TXU's proposals regarding billing would violate G.L. c. 164, § 1D. The Grid should see that this is not the case when it reviews TXU comments. Under the TXU proposal, billing could be provided in two ways. First, a retailer could procure billing services from the utility, which would continue to "create and send bills to retail customers" as required by § 1D. The only difference between the current system and the system TXU proposes is that the retailer would pay the utility, based on tariffs approved by the Department, for "creating and sending bills to retail customers" and the retailer would control the content of the bill, subject to regulations set by the Department. This proposal addresses all of the concerns that led to the passage of § 1D. Since the utility would continue to "create and send the bills," they would be as accurate and timely as they are now. The utility would also remain the monopoly provider of billing services, so there would be no impact on utility staffing levels and no possibility that the arrangement would run afoul of § 312 of Restructuring Act's prohibition against opening billing services to competition. Nothing in § 1D or § 312 governs the format or content of the bills so long as the utility continues to "create and send" them in either a consolidated or separate manner, which would be the case under TXU's proposal.<sup>14</sup>

Alternatively, TXU has suggested that the Department could designate an alternate default service provider, pursuant to G.L. c. 164, § 1B(d), and that the alternate default service provider could provide all retail services itself, including billing, as does the utility now when it provides default service. As explained in TXU initial comments, this proposal is consistent with both § 1D and § 312, and would provide customers with an attractive alternative to utility service. This proposal could not be

implemented unless the Department found it to be “in the public interest,” a standard that would require the Department to weigh the costs and benefits for customers of the alternative arrangement. Clearly, if the Department found that a retailer applying to be a default service provider was not capable of providing the service at least as efficiently as the utility, or that the retailer’s proposal did not comply with applicable statutes, the petition would not be approved.

**D. The National Grid proposal adds pseudo-retail elements that will raise the price of default service while bringing no benefits to consumers.**

In contrast to the TXU retail unbundling plan, National Grid proposes changes to default service that would raise prices without any corresponding benefits for consumers. This is true under either the “wholesale option” or “retail option” described in Grid’s initial comments, although there is no reason to believe a retail supplier would ever win an auction in which it competes head-to-head with wholesale suppliers. In any event, Grid itself describes the proposals as being “identical.” National Grid Initial Comments at 13. TXU encourages the Department to reject both plans.

**1. National Grid’s Proposed Retail Auction Pricing and the “Retail Value Credit” Are Economically Unjustifiable and Will Result in a Blatant Cross-Subsidization of National Grid’s Delivery Services that Will Distort the Massachusetts Electricity Market.**

National Grid proposes a unique method for determining the basic service price that would result from its retail auction. National Grid would accept bids for each of its four subsets of default service customers, and would choose the low bidder for each group as the winner of the right to serve

---

<sup>14</sup> TXU strongly encourages the Department to advocate opening billing services to competition, recognizing that such a change would require legislative action.



that group. Each of the four winners would receive its bid price from the Grid. The customers in the four groups all pay the same price, however, which would be the highest of the four winning bids.<sup>15</sup>

This proposal has two major flaws. First, it is an inefficient auction design when compared to the two designs used currently in New England power markets. In the day-ahead commodity markets run by ISO New England, the clearing price is set by taking increments of supply, starting with the lowest bid price, until all demand is met. The price of the last increment of supply that meets the last increment of demand is the price that “clears the market,” **and every seller receives the market clearing price**. The prospect of keeping the difference between one’s marginal costs and the market clearing price helps drive prices to marginal cost and encourages entry of more efficient sellers. The National Grid plan creates no such incentive, since bidders receive only their bid price.

The other familiar auction design is that currently used by utilities to procure default service generation from wholesale suppliers. An increment of default service load is put out for bid, and the lowest qualifying bid wins. Customers pay, and the wholesale supplier receives, the bid price. While the current system is flawed because, as discussed in TXU’s initial comments, it does not include all of the components of retail service, the basic auction design is one that could be used should the Department transform default service into a true retail service. The National Grid auction plan uses neither accepted method, and provides no justification for imposing one group’s price on all groups. As discussed further below, there is no justification for doing so.

---

<sup>15</sup> It is interesting that National Grid proposes creating a separate group for G-1 customers and including this group with the three residential groups. Under the current default service rate structure, G-1 customers would take service under the commercial rate, which happens to have been the highest of MECo’s three default service prices since the Department ordered market-based pricing for default service. If this pattern continued under the National Grid auction plan, the G-1 group would generally set the price for the three residential groups, increasing their rates and creating additional “margin” that would be applied to the Grid’s delivery rates.

The National Grid auction plan's other major flaw is the characteristic that makes it attractive to the Grid: the Grid gets to apply the difference between what it charges customers and what it pays suppliers to its delivery charges. The Grid uses a variety of euphemisms such as "retail value credit" and "margin," but these terms cannot hide the fact that National Grid wants customers to overpay for default service in exchange for a potential or purported decrease in delivery rates funded by that overpayment. This proposal would violate both the Restructuring Act and the Department's most basic rate-making principles, and would distort the Massachusetts electricity market by sending false price signals to default service customers.

The Restructuring Act requires that the default service rate "not exceed the average monthly market price of electricity." G.L. c. 164, § 1B(d). The basic service price proposed by the Grid is, in no sense, a "market price of electricity."<sup>16</sup> By dividing its default service customers into four groups, and auctioning the right to provide service to each group separately, the National Grid plan creates four separate "markets." Since the division among the groups must be strictly enforced for purposes of bad debt allocation, and since the auctions will be held at different times, the resulting prices can hardly be compared to the undifferentiated "market price" that results from the ISO New England process, or even the current default service procurement process. The four groups are not even from the same rate class; three are residential, the other is small commercial. There is no economically justifiable reason to impose the "market price" for one group on the other three, any more than one could justify imposing the "market price" paid by National Grid's default service customers on NSTAR's customers.

---

<sup>16</sup> National Grid makes no pretense that the basic service price meets this definition. It merely asserts that it will "define the market price as the highest of the winning bidders with contracts outstanding for the relevant period," thereby setting its premise equal to its conclusion, by which method one can prove anything.

Further, taking National Grid's over-collection of default service charges that it refers to as the "retail value credit" and applying it to the Grid's own delivery charges would violate a basic principle of rate-making, avoiding cross-subsidization. *See, e.g., Standard of Conduct*, D.T.E. 97-96 (May 29, 1998) ("cross-subsidization is of critical concern in the rate-making process"). National Grid's proposal would move default service from a format that is already flawed (since it represents only a pass-through wholesale price rather the price for a true retail service) to one in which amounts collected for default service are applied, without any economic justification, to delivery charges.

The result would be a complete distortion of the electricity market in National Grid's service territory. The Grid would apply the "retail value credit" equally to all customers who would be eligible for basic service. As a result, three-fourths of the default service customers would be paying a price higher than their suppliers bid, with the excess amounts going to reduce the delivery charges for customers in all four groups. This would create two problems. First, customers in those three groups would respond to offers from competitive suppliers that appeared attractive only because of the inflated generation price. Any competitive supply offer that beat the basic service price by an amount less than or equal to the "retail value credit" would appear to be attractive, but if the customer were paying his supplier's bid price, the customer would see that the competitor's price was not, in fact, lower. In the meantime, customers in the fourth group would receive a decrease in their delivery charges, courtesy of the other three groups, even though they are the only group receiving a correct generation price signal, since the basic service price is equal to their supplier's bid.

There would be no benefits whatsoever from this cross-subsidization between rate components and among separate default service groups. The only benefit identified by the Grid is the "incentive" for switching to competitive supply created by artificially increasing the default service price. National Grid

Initial Comments at 16-18. If the Department were interested in such artificial methods for increasing the rate of switching from default service to competitive supply, it could introduce such a system now by employing a “competitive adder” to the default service rate and subtracting the same amount from the utility’s delivery rate. The result would be the same: customers who accepted offers from competitive suppliers at price between the artificially inflated price and the true price would do so only because they were given false information about the cost of the different components of their electric service. Surely the Department will favor a market that allows for and encourages efficient entry of competitive firms over one that increases switching by misleading customers with incorrect price signals.

**2. National Grid’s “Wholesale Option” would inefficiently shift costs to wholesale suppliers, which would raise prices to consumers.**

Under the wholesale option, “the wholesale contract and basic service terms and conditions will be consistent with the wholesale contracts that Mass. Electric has used in the past, **modified to reflect the changes associated with basic service**” (emphasis added). The National Grid comments describe the wholesale option further as follows:

Under the wholesale option, a winning bidder would be (1) assigned the responsibility to supply a subset of Mass. Electric’s customers, rather than all of the customers in the class; (2) required to bid a single price for electricity supply, rather than a price that varies from month to month; (3) required to bid for periods of up to two years in the standard offer procurement program if conditions warrant, rather than current practice that limits procurements to a single year; (4) responsible for all losses down to the customer’s meter; and (5) paid only its allocable portion of amounts actually received by Mass. Electric from retail basic service customers assigned to the supplier. National Grid Initial Comments at 27.

National Grid does not identify a single benefit to customers associated with these changes. The Grid makes the vague, unsupported claim that these “variations from today’s practice . . . may be appropriate to encourage the development of the market even if the retail supply of basic service were

not allowed.” National Grid Initial Comments at 26-27. However, there is nothing about these changes to the obligations of wholesale suppliers that would do anything to “encourage the development of the market.” The suggested changes would only raise prices, with no corresponding benefit for customers. This is especially true of the Grid’s proposal to shift the bad debt risk to wholesale suppliers.

According to the Grid’s comments,

the wholesale supplier would assume the bad debt risk of retail customers and, accordingly, would receive only the portion of payments from retail customers associated with the wholesaler’s winning bid that was actually paid to Mass. Electric by the customers in the wholesaler’s auction block. Thus, a wholesale supplier would be subject to the same bad debt risk as a retail basic service provider. National Grid Initial Comments at 13.

This change would be bad for everyone, except National Grid. Here is why. First, the premise of the Grid’s proposed changes to the current wholesale agreement with default service suppliers is pure fiction. In the scenario in which the Grid divides its default service customers into four “auction blocks” for purposes of accepting wholesale bids to supply service to those customers, **all** of the customers remain retail customers of National Grid. The idea that any particular customer or group of customers is “associated with” a particular wholesale supplier is nonsense. It would be like claiming that, for a generation-owning utility, particular groups of customers are “associated with” particular power plants, or that customers of a particular gas station are “associated with” a particular oil refiner, or that customers of a particular McDonald’s are “associated with” a particular cattle feed lot. The phrase “associated with” is meaningless. All of the customers are National Grid customers. National Grid has a statutory obligation to buy power to supply those customers. Whether it meets that obligation by buying from one wholesale supplier or a hundred wholesale suppliers makes no difference whatsoever so far as the relationships between the Grid and its retail customers are concerned. The only

“association” that matters to the retail customer is the one with his or her retail supplier, which would continue to be National Grid.

While fictional, this meaningless “association” between a wholesale supplier and an end-use retail customer is not without severe consequences, since National Grid uses it to justify shifting to wholesale suppliers costs that the Grid itself is in the best position to bear. Legally, an end-use customer can have only one retail supplier, which would be National Grid in this case. An end-use customer can also have only one distribution company, which would also be National Grid in this case. Thus, only National Grid would have a contractual relationship of any kind with the end-use customer. Only the Grid would have any remedy against any retail customer who did not pay. Wholesale suppliers have no contractual relationship of any kind with retail customers, and thus have no remedies for non-payment.

The current system of wholesale procurement for default service reflects this contractual reality. A wholesale supplier of default service has one contract, with the utility. If either the utility or the wholesale supplier does not perform, the other can exercise its contractual remedies against the party in breach. If the utility’s customers do not pay, the utility exercises the options available to it under its tariffs and state law. Each party remains in control of its own contractual destiny, and assumes the risk that the party with which it is in contractual privity may not perform.

Shifting responsibility for National Grid’s bad debt to wholesale suppliers tosses all of these well-ordered cards in the air. The wholesale supplier would now have to cover a cost over which it had no control. Having no contractual relationship with non-paying retail customers, the wholesale supplier would be forced to rely on National Grid’s good graces to pursue non-payers with the same vigor as it did when the Grid itself was responsible for all bad debt. But no rational company would act in such a

manner. By shifting the bad debt associated with default service generation to another party, National Grid would cut its total default service bad debt exposure nearly in half.<sup>17</sup> There is no reason to expect that the Grid would continue to pursue collections activities as aggressively as it currently does with only half as much money at risk. The Department's pro rata allocation of customer payments between generation and delivery charges will ameliorate this effect somewhat, but there is little question that should the Department allow such a shift in bad debt responsibilities, collections activities would become a prime target for National Grid cost-saving measures.

This system adds a new layer of risk, and associated cost, to consumer bad debt. Wholesale suppliers will have to assess not only the likely bad debt attributable to the group of customers they will be "associated with," the suppliers will have to assess the risk that National Grid collection efforts will be less diligent under the new system than when its own money was at risk. Wholesale suppliers would have no choice but to adjust their bids upward accordingly, since the actual bad debt attributable to that customer group could well be higher going forward than the level of bad debt attributable to the same group had been in the past. The result will be higher prices to the Grid's default customers.<sup>18</sup>

Shifting the responsibility for bad debt to wholesale suppliers would also require additional oversight by the Department. The National Grid proposal would create a new, pseudo-contractual

---

<sup>17</sup> MECo's current default service rate of 6.203 cents/kWh is about half of the total per kWh charge for the R-1 class. Thus, by shifting the bad debt risk associated with about half of its R-1 class default service revenues to wholesale suppliers, National Grid would reduce its overall bad debt exposure attributable to default service by half.

<sup>18</sup> It is also possible that the division of the default service customer group into four sub-groups would affect wholesale suppliers' perception of the volumetric risk associated with default service. In the current system, wholesale suppliers take on some percentage of the total, undifferentiated volumetric risk associated with the entire default service customer group. In that system, the risk of an unusually large migration of customers into or out of a particular sub-group, such as the opening or closing of a residential apartment building or small retail shopping complex, is spread over the entire group. If the group is split into three sub-groups, the wholesale supplier for a particular sub-group would absorb the full impact of such events. In the short-term, until the effect of this subdivision on volumetric risk can be observed and studied, the possibility that it will have a negative effect on a

relationship between retail customers and wholesale suppliers. Since this relationship would have a real impact on what the Grid pays wholesale suppliers, the Department would have to find a way to police the division of National Grid's default service customers into the groups that would be "associated with" a particular supplier. If the boundaries between the groups became fluid (which is a real risk, since the boundary is purely a construct in the first place), the utility could shift non-paying customers from group to group, allowing it to reduce its payments to each wholesale supplier. The Department would also have to devise a method for assigning new customers to and subtracting departing customers from the designated groups, since the precise composition of those groups would have an impact on wholesale supplier revenues.

**3. National Grid would keep any savings that might result from its retail auction plan, while immediately passing on all costs to consumers.**

While giving the appearance that its proposals would result in savings to customers, National Grid's comments make clear that it would keep some of these savings, while passing on any associated costs to customers. With respect to bad debt, the Grid maintains that shifting this risk to retail suppliers under its auction plan would not trigger a rate reduction under its settlement. National Grid Initial Comments at 25. They assert that "retail suppliers have always been responsible for bad debt expenses under our settlement," so that the exogenous factor change provision would not apply "to bad debts allocated to retail suppliers under our proposal." *Id.* This position is a non sequitur. National Grid currently takes on all of the bad debt risk for its default service customers, since it provides those customers with a fully bundled service, including generation. If National Grid shifts the bad debts risk associated with that group of customers to another supplier, National Grid's costs go down, period.

---

wholesale supplier's risk position would, alone, tend to increase the wholesale prices that National Grid will pass



The fact that National Grid “did not commit to indemnify any other suppliers bad debts” is the very point here; default service would change from a service for which National Grid bears all of the bad debt risk to one in which much of that risk is shifted to suppliers, thus decreasing the utility’s costs. There is no justification for allowing National Grid’s shareholders, rather than its customers, to enjoy the benefits of this reduction in utility costs.

On the other side of the ledger, National Grid asserts that “the potential for costs associated with a supplier failure” under its procurement program “represents a cost that is directly associated with the supply of basic service” and, thus, should be passed on to customers by reducing their “retail value credit.” TXU believes the more appropriate way to deal with supplier failure is by requiring adequate security to become a licensed supplier in Massachusetts.<sup>19</sup>

## CONCLUSION

The initial comments in this proceeding confirmed TXU’s view that the Department faces a clear choice between those, like the utilities, who would continue the status quo indefinitely and those, like TXU, Centrica, DOER, and the other retailers, who would have the Department move decisively in favor of a true retail market. Full rate unbundling for all retail services is the most critical step on the path to such a market, and TXU encourages the Department to move with all due speed to begin proceedings that would lead to unbundled tariffs for all retail services currently provided by

---

directly on to its customers.

Massachusetts utilities. By combining that step with immediate improvements in default service pricing and procurement, such as those presented by DOER, the Department will once again put Massachusetts at the forefront of electric restructuring. Without unbundling, however, true retail competition cannot take hold, and retailers such as TXU will be forced to look to other markets that have taken or are taking this critical step. In either event, TXU encourages the Department to act decisively so that all parties will know the direction in which Massachusetts is moving, and can plan accordingly.

Dated: September 9, 2002.

Respectfully submitted,

---

John A. DeTore  
Christopher H. Kallaher  
Rubin and Rudman LLP  
50 Rowes Wharf  
Boston, MA 02110  
(617) 330-7213

---

<sup>19</sup> *See, supra*, Note 9.